

FINANCIAL ISSUES**1 Introduction**

1.1 This appendix deals with the financial issues relating to the Project. The main issues are:

- Value for Money
- Affordability
- Foreign Exchange Strategy
- Budgetary Treatment
- Funding Solution
- Termination of the Contract

2. Value for Money for the Public Sector

2.1 In order to confirm whether the preferred PFI procurement route will deliver VfM in comparison to traditional procurement, the City Council has utilised the HM Treasury 'Value for Money Assessment Guidance'. The process commenced at the Outline Business Case (OBC) stage when a stage 2 qualitative assessment was carried out which demonstrated that procuring the Project through a PFI contract was the best solution for the City Council.

2.2 A stage 3 qualitative assessment has also been carried out as part of the Final Business Case and the City Council is satisfied that the required objectives of the assessment have been met namely;

- Market Failure - there has been sound competition throughout the procurement process which was ultimately evidenced by the receipt of strong final tender bids which broadly accepted the City Council risk profile and were competitively priced.
- Efficiency of the procurement process - the City Council has a history of successful procurement for a number of PFI projects over a range of sectors. The procurement has been structured to ensure an efficient process which has had the effect of controlling bid costs from both a City Council and bidder perspective. On this basis the procurement process has not impacted adversely on VFM; and
- Risk Transfer – the risk transfer is achievable and comfort can be taken from the significant due diligence undertaken by Veolia during the procurement process.

2.3 Consideration has also been given to the VfM of Veolia's proposal by testing it against conventional procurement methods using the HM Treasury Quantitative evaluation model.

2.4 The results from the HM Treasury model show an indicative VfM of £5m or 2.66% in favour of the PFI option. This suggests that the PFI option would deliver better value for money compared to conventional procurement methods for this project.

3. Affordability of the Project to the City Council

3.1 The cost of the PFI project to the City Council over the life of the Contract is summarised in the table below compared to the position reported previously at the time of submission of the Pre- Preferred Bidder Final Business Case (PPB FBC).

City Council Cash Flows	PPB FBC Nominal £m	FBC Nominal £m
Unitary Charge (including NNDR)	452.854	457.113
Landfill Tax	12.451	-
Contract Monitoring	3.737	3.737
Total City Council Costs	469.042	460.850
Less PFI Credit income	(134.111)	(134.111)
Total required City Council budget	334.931	326.739

3.2 The total cost to the City Council has decreased by c.£8m in the period between PPB FBC and the FBC as a result of the following changes made to the financial solution;

- a change to the way that inflation is applied to some revenue streams within the project – saving of c.£2m;
- a change to the payment of invoices at the start of each month – saving of c £5m; and
- transfer of landfill tax price uncertainty to the Contractor – saving of c. £1m.

3.3 A revised price ceiling (setting out the maximum Unitary Charge) of £660.9m was approved by Executive Board in November 2011 based on the PFI project costing no more than a ‘do nothing’ scenario in which all remaining residual waste, following the introduction of planned service developments, is sent to landfill.

3.4 It should be noted that the contract management costs identified in the table above relate to the operational period of the contract only. Additional costs will be incurred during the planning and construction period of the contract.

3.5 The total Unitary Charge payable by the City Council from the date of Service Commencement onwards is now £457m, a saving of £203.9m when compared to the ‘do nothing’ price ceiling of £660.9m. To provide an annual context, it is estimated that the ‘do nothing’ cost that would arise from the landfilling of residual waste in 2016/17 would be c.£16m. The total cost to the City Council of the residual waste project, net of PFI credit income, will be c.£12m representing a saving of c£4m in the first fully operational year.

3.6 There will be, however, a further cost incurred by the City Council during the commissioning period (September 2015 to March 2016) which is anticipated to be in the region of £5m. This will replace the landfill cost that the City Council would have otherwise incurred during the same period. During this time the contract will operate in a similar manner to the period after Service Commencement.

3.7 Given that the price ceiling of £660.9m is considerably higher than the projected unitary charge at financial close of £457m, it is considered appropriate to obtain approval to execute

the contract up to an amount lower than the existing price ceiling. The approval threshold is recommended to be £502m, which should allow sufficient headroom for any adverse movements in foreign exchange rates (see section 5 below) and any other cost changes that may arise out of the remaining procurement process prior to financial close.

4. Financial Risks

Waste flows

- 4.1 It should be noted that the Unitary Charge information above is based upon estimated wasteflow forecasts undertaken in conjunction with the Council's technical advisors in 2011, which projects an average yearly wasteflow of 145,000 tonnes. The actual cost of the contract will depend upon the volume of waste delivered to the facility each year, and the Unitary Charge will be calculated upon the basis of a banded gatefee structure. For indicative purposes only, the impact of an additional 5,000 tonnes of waste per annum would increase the total Unitary Charge by approximately £16m to £473m over the life of the contract. This equates to an additional charge of £464k in the first full year of operations.
- 4.2 Furthermore, a minimum annual tonnage of 120,000 tonnes has been set. In the event that the City Council delivers below this minimum, it will be required to pay for the minimum tonnage in full, unless alternative waste can be sourced. Based upon existing wasteflow forecasts, this scenario is considered unlikely, and the City Council has additional non kerbside collected waste streams which could utilise the some or all of the capacity.

Risks Pre Financial Close

- 4.3 A number of financial risks remain up to financial close including:
- Foreign exchange – section 5 below;
 - Amendments to project costs – which could arise from ongoing discussions to finalise contract terms, including discussions relating to offsite and highway works; and
 - Delay to the financial close - a delay beyond the fixed price bid validity period (30th September 2012) could impact upon price, however the Preferred Bidder has stated that a delay to close should not have a detrimental impact on price provided that the construction start date is not adversely affected.

Risks Post Financial Close

- 4.4 A number of financial risks will remain after financial close (in addition to those set out above) as follows, each of which is contained within the contract terms, and which will therefore be accepted by the City Council at financial close:
- Planning delay - a delay to the anticipated planning approval date (beyond the 12 months included within the current programme) will result in the application of indexation to existing project costs. It is estimated that a 6 month delay will result in an additional cost to the City Council of approximately £350,000 per annum for the operational life of the contract;
 - Planning failure – failure to obtain the necessary planning permissions would result in contract termination. The potential cost associated with termination in this scenario is set out in the confidential appendix.
 - Some costs associated with the planning process, which could include costs arising from any appeal process, or costs incurred to meet planning requirements arising after financial close;

- Changes to the estimated cost of business rates, which is a pass through cost to the Council, and will not be confirmed until the facility is built;
- Actual inflation rates higher than the annual rate of 2.5% assumed in the financial model. Latest figures published by the Office of National Statistics (ONS) in December 2011 suggest RPIX rates are currently 4.95%; and
- Amendments to foreign exchange hedging instruments, outlined further in paragraph 5 below.

5. Budgetary Treatment

- 5.1 As part of the assessment of readiness to close dialogue, the City Council completed an ESA95 assessment and concluded that the project would not be on the public sector balance sheet for the purposes of central government budgeting under ESA 95.
- 5.2 The City Council's budgetary treatment for the reporting of International Financial Reporting Standards (IFRS) concluded that the scheme falls within the scope of International Financial Reporting Interpretations Committee (IFRIC) 12 Service Concession Arrangements and will be treated as 'on balance sheet' for the purposes of Leeds City Council accounting.